The Budget Outlook

The Newsletter of the Senate Budget Committee Majority Staff
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Keeping Track of the Surplus: How Much Do We Have Left?

ONE OF THE RESPONSIBILITIES of the Budget Committee Chairman is to track the budgetary impact of legislation to determine whether it will cause a raid on the Medicare and Social Security Trust Fund surpluses. *The Budget Outlook* will keep a running tally of where we stand in relation to the trust funds as the Congress passes legislation affecting outlays and revenues throughout the summer and fall. Below is an explanation of our calculations determining where we are now, where we are headed, and where we could end up.

Where Do We Start? May CBO Baseline

We begin by defining the "available" budget surplus as the amount of surplus excluding the Social Security and Medicare Hospital Insurance Trust Funds. CBO's latest projection – released in May – shows an available baseline surplus of $92 billion in 2001, $95 billion in 2002, and $2.7 trillion over the ten-year period 2002-11.

It is important to note that we use the May CBO projection and not the previous January or March CBO estimates. The updated May CBO projection takes into account the recent anticipated downturn in the economy and is clearly a better reflection of the actual surplus available. Projections using the earlier CBO estimates disregard the impact of the economic slowdown and understate the cost of certain budget policies.

The budget resolution specifically gives the Budget Committee Chairman the authority to score legislation for enforcement purposes based on CBO's updated baseline (Budget Resolution Conference Report, Section 221, p.26). Further still, explanatory language in the budget resolution this year states that "it would be ideal to enforce [the budget] resolution using CBO's best cost estimates based on its most recent baseline" (Budget Resolution Conference Report, p.86).

Where Are We Now? Adding in Tax Bill

When we factor in the cost of the massive tax bill just passed, we find that the available surplus drops to $16 billion in 2001, $52 billion in 2002 and $1.1 trillion over the ten years. These estimates represent where we stand today.

Where Are We Headed? Adding in Policies Assumed in the Budget Resolution

Looking forward, if we assume enactment of the policies already laid out in the budget resolution, we see that the available surplus will be further reduced to $5 billion in 2001, $25 billion in 2002, and $471 billion over the ten years. We can also see that just the enactment of the tax bill and the budget resolution policies will result in a raid of the Medicare Trust Fund surplus by $5 billion in 2003 and $4 billion in 2004.

(continued on page 3)

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Figure 1-1
Tax Bill leads to raid on Trust Funds

Status of "Available" Budget Surplus
(Total budget surplus excluding the Social Security and Medicare Trust Funds; in $ billions)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	10-yr
CBO May Baseline	92	95	125	155	173	225	279	324	385	459	525	2,745
Baseline + Tax Bill	16	52	26	33	46	62	90	116	157	198	308	1,088
Baseline + Tax Bill + Resolution	5	25	-5	-4	1	11	21	39	72	104	206	471
Baseline + Tax Bill + Resolution + Defense	6	12	-22	-23	-21	-15	-7	7	37	65	160	193
Baseline + Tax Bill + Resolution + Defense & Education	6	9	-29	-35	-36	-33	-29	-17	10	35	128	3
Baseline + Tax Bill + Resolution + Defense & Education + Possible Economic Revisions	-2	-11	-51	-56	-55	-49	-44	-30	-3	22	115	-162
• Raid on Medicare HI trust fund	-2	-11	-41	-43	-42	-45	-43	-30	-3	0	0	-257
• Raid on Social Security trust fund	0	0	-10	-14	-13	-4	-1	0	0	0	0	-41

Tax Bill Gimmickry

IN A RECENT *Washington Post* op-ed, Office of Management and Budget Director Mitch Daniels warned that the shift in control of the Senate could threaten to undermine the "first orderly, responsible budget and appropriations process in many years ..." This statement is truly astounding, as it was written just days before President Bush signed into law one of the most shamelessly gimmick-riddled, back-loaded tax bills ever devised.

The tax bill writers used an array of phase-ins, phase-outs, and revenue shifts to keep the visible cost of the bill within the $1.35 trillion eleven-year limit set by the 2002 budget resolution. *The Budget Outlook* takes a closer look at some of the tax bill's gimmickry below:

The Nine-Year Decade:

The tax bill was originally advertised as a ten-year bill, covering the period from 2002 through 2011. After a 2001 stimulus package was added, the bill was referred to as an eleven-year tax bill. But a series of last-minute deals pushed up the cost by hundreds of billions of dollars – well above the $1.35 trillion eleven-year limit. Instead of reducing the most costly and unfair component of the tax bill – the deep cuts in the top rate brackets – the tax bill writers resorted to the "mother" of all gimmicks, simply sunsetting all of the tax cuts at the end of 2010, lopping-off a substantial chunk of the cost of the bill in its final year.

It was always expected that the tax bill would sunset all of the cuts at the end of 2011 to avoid a "Byrd-rule point of order" – a budgetary restriction requiring 60 votes to pass any measure that reduces revenue outside the ten-year window of a given budget. By sunsetting the tax cuts a year earlier than they needed to, the tax bill writers were able to cynically hide the true cost of the bill, which, according to the Joint Committee on Taxation, is actually much closer to $1.8 trillion.

The $33 Billion Tax Payment Shuffle:

To avoid raiding the Medicare Trust Fund surplus to pay for their massive tax cut, tax bill writers resorted to another classic gimmick – the tax payment shuffle. Fourth quarter corporate estimated tax payments are usually due on September 15, with the revenue counted toward the current fiscal year, which ends two weeks later. Tax bill writers simply included a line delaying these tax payments until October 1 this year, in order to move $32.9 billion of receipts from fiscal year 2001 to fiscal year 2002. A similar delay will be made in 2004 to move $6.6 billion of receipts into fiscal year 2005. Without these changes the tax bill would raid the Medicare Trust Fund surplus in both 2002 and 2005.

The AMT Shell Game:

The tax bill writers clearly recognized that their tax cut would worsen the problem of the AMT hitting taxpayers it was never intended to affect, but they provided only a partial and short-term fix to the problem. The tax bill raises the amount of income excluded from the AMT for the years 2001 through 2004, but inexplicably terminates this AMT relief at the end of 2004 – raising taxes for many subject to the AMT just as they will be expecting the bulk of their tax cut to kick in. A permanent fix to just the AMT problem created by the tax bill could cost more than $200 billion over the ten years. We can only assume that the tax bill writers cut off the AMT relief to make room for the upper rate bracket cuts and other measures that phase in during the later half of the decade.

If the tax bill goes into effect as is, without any further fix to the AMT, more than 35 million taxpayers

Figure 2-1
Tax Bill is loaded with phase-ins, phase-outs, and gimmicks

Now You See It, Now You Don't ...

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Tax Rate Cuts 39.6% 36% 31% 28%	 38.6% 35% 30% 27% 10% created			 37.6% 34% 29% 26%		 35% 33% 28% 25%					All Changes TERMINATED 39.6% 36% 31% 28% ELIMINATED
Marriage Penalty Relief					Phase-in Begins				Phase-in complete		Relief is TERMINATED
Child Credit	Increases to $600				Increases to $700				Increases to $800	Increases to $1000	REVERTS BACK to $500
Education Deduction		Created: Up to $3000		Up to $4000		Education Deduction ELIMINATED					
Estate Tax		$1 million exemption		$1.5 million exemption		$2 million exemption			$3.5 million exemption	Estate Tax Repealed	Estate Tax REINSTATED
Additional AMT Exemptions	Begin Higher Exemptions				Higher Exemptions ELIMINATED						

– almost one in every four taxpayers – will be hit by the AMT in 2010. This will be a huge increase from the 1.5 million taxpayers who pay the AMT today and nearly twice as many as would be subject to it under current law.

The Education Deduction Bait-and-Switch:

Much like the disappearing AMT relief, the tax bill also includes 'now-you-see-it-now-you-don't' relief for the cost of higher education. The new deduction for education expenses in the tax bill is phased-in gradually from 2002 to 2004 and then is abruptly eliminated in 2006, again for no apparent reason.

The Phase-ins:

Other than the rebate checks being mailed out this summer and fall, it is stunning how back-loaded this tax bill really is. In full, more than two-thirds of the cost of this tax bill will come between 2006 and 2011. Some of the provisions start so late in the decade or are phased-in so slowly that they do not become fully effective until just before they are repealed by the sunset provisions. The key income tax phase-ins of the tax bill include:

- Unlike all other brackets, the new 10 percent bracket is not indexed for inflation until 2009. Even with an increase in the bracket in 2008, the real value of the tax cut provided by this provision is smaller than it would be if indexing were immediate.

- Upper bracket rate reductions do not become fully effective until 2006.

- Repeal of the "Pease" limitation on itemized deductions and the personal exemption phase-out ("PEP") for upper income taxpayers does not begin until 2006 and is phased-in over 5 years.

- The increase in the child credit is phased-in gradually, with the full $1000 per child credit not becoming effective until 2010.

- Marriage penalty provisions are phased in over 5 years beginning in 2005, also not becoming fully effective until 2010.

- The full phase-in of IRA contribution limits does not take effect until 2008.

- The increase in exemptions for estate taxes is phased-in gradually from the current $675,000 to $3.5 million by 2009, with full repeal not taking effect until 2010. The top estate tax rate is also reduced gradually from its current level of 55 percent to 45 percent in 2007. The gradual phase-in of the estate tax provisions greatly reduces the cost in this decade – estimated at $138 billion – but hides the fact that full repeal will probably cost close to $750 billion in the ten years that follow. ■

Tracking the Surplus

(continued from page 1)

What Else Is Left Out? Adding in Defense and Education Spending

Unfortunately, this year's budget resolution is incomplete. It leaves out huge expenses in the areas of defense and education that we know are coming. Instead of providing for an increase in defense spending to fund expected recommendations from the President's National Defense Review, the budget resolution simply allows the Budget Committee Chairman to add new defense resources above the discretionary spending levels in the resolution. In addition, the budget resolution fails to provide any new resources for education, even though education is supposedly a priority of the President and it has always been anticipated that additional resources for education would be required as part of the education reform measure moving through Congress.

If we add in the 10-year cost of the additional defense spending requested by the President in late June, we see that the available surplus will be reduced to $6 billion in 2001, $12 billion in 2002, and $193 billion over the ten years. We also see that the added defense request will result in a combined raid of the Medicare Trust Fund surplus of $88 billion between 2003 and 2007.

If we further add in a rough estimate of the possible additional expenditure for education, we see that the available surplus will decline to $6 billion in 2001, $9 billion in 2002, and $3 billion over the ten years; and the Medicare Trust Fund will be raided every year from 2003 through 2008.

Where Could We End Up? Adding in Possible Economic Revisions

Finally, it is also prudent to consider the impact of possible downward revisions of the economic forecast later this summer. Given the recent slow down in the economy, Budget Committee staff has estimated that a slightly weaker forecast could further reduce the size of the available surplus by $165 billion or more over the next ten years. Under this scenario, the Medicare and Social Security Trust Funds will be raided by $257 billion and $41 billion respectively over the ten years. The raid on the trust funds will be even larger if gimmicks in the tax bill (including the sunset provision) are removed.

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Energy Cuts in Bush Budget Contradict Rhetoric

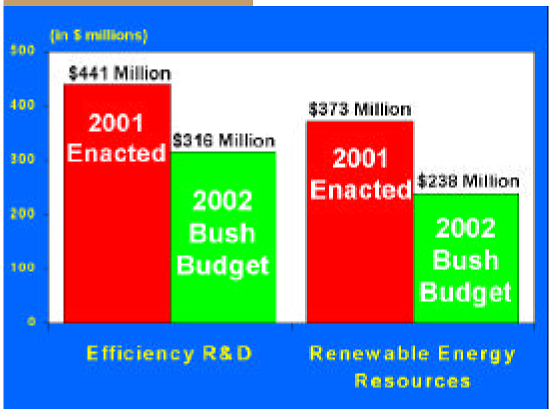

Figure 3-1
Bush Cuts in Renewable Energy and Energy Efficiency

PRESIDENT BUSH, RELEASING his National Energy Policy on May 17, described his plan as one that "begins with a 21st century focus on conservation" and "supports the development of new and renewable sources of energy." That's nice rhetoric, but it's not backed up by a budget that makes appropriate investments in energy.

A close look at the Bush Administration's 2002 budget shows that its approach to energy is more 19^{th} century Industrial Age than 21^{st} century clean and efficient. In order to make room for its massive tax cut, the Bush budget, released April 9, proposed cutting Department of Energy renewable energy programs by 36 percent – $136 million – from 2001, and energy efficiency research and development by 28 percent – $125 million. Since then, the Administration has forwarded Congress a budget amendment to put $39 million back in renewable energy programs, but only after cutting that money out of efficiency activities. Overall, the Administration proposed cutting $456 million from the Department of Energy's budget compared to 2001.

These cuts are a mistake given the country's current energy situation. Recent problems with high energy prices nationwide and rolling blackouts in California underline the severity of our energy problems. At the same time, the environmental costs of our energy use have never been more apparent. On June 6, the National Academy of Sciences presented the White House with the latest in a series of studies concluding that climate change is real, and that a primary cause – carbon dioxide buildup in the Earth's atmosphere – comes most commonly from human fossil fuel burning (i.e. coal, oil, and gas) to produce energy. To respond to these problems, we should be doing more – not less – to develop additional reliable, affordable, and clean energy supplies, and to promote energy efficiency.

Clean renewable energy sources such as solar, wind, and biomass currently provide only about 8 percent of our total energy supply, but with the proper investments in research and development they could provide much more. A 1997 study by the President's Committee of Advisors on Science and Technology (PCAST) found that costs of energy from renewable sources such as wind turbines have come down by as much as 90% from their original cost; and the Shell International Petroleum Company projects that by 2025 renewables could contribute one-half to two-thirds of the global energy currently provided by fossil fuels.

Similarly, instead of dismissing conservation as a "personal virtue," we can and should do more to use energy more efficiently on a national level. The benefits of energy efficiency are proven. Through past steps to decrease the intensity of our energy use, consumers currently save an estimated $170 billion per year, and U.S. air pollution emissions are about one-third lower than they would otherwise be.

To tap the full potential of renewable energy and energy efficiency, we need to continue to fund programs that work with industry to research and develop improved technologies until these technologies become established in the market. PCAST recommended more than doubling federal spending on energy efficiency and renewable energy research and development. Instead, the Bush Administration has cut funding for both. The Bush energy plan calls for "review[s]" of existing renewable and efficiency programs, and holds out hope for more funding later. But it's not clear where this new money will come from – particularly now that we have a tax cut soaking up almost all available resources through the next decade. ■

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